




The Black and White of Fraud, Waste, and Abuse

Bruce Burton ■ Lauren McLean



Defense budgets and procurement activity have risen dramatically over the years, increasing from \$304 billion in fiscal year 2000 to almost \$700 billion in fiscal year 2008.

Contracting for goods and services also saw substantial increases, with more than \$315 billion awarded on contracts in 2007. The volume alone created a strain on DoD procurement resources, but when it is considered that resource levels remained flat during this time, the environment was ripe for increased opportunities for fraud. Throw in increased urgency in DoD's support for the warfighter and you create the perfect storm for fraud, waste, and abuse; and that is exactly what we see in the news headlines on almost a daily basis.

Burton is the deputy assistant inspector general for the acquisition and contract management directorate in the DoD Office of the Inspector General. **McLean**, currently in the Audit Policy and Oversight branch in the DoD Office of the Inspector General, has numerous years of experience as an auditor, both in DoD and industry.

Some examples of eye-catching headlines:

"Feds Charge 22-year-old Pentagon Contractor with Procurement Fraud"—This case involved a defense contractor who defrauded the government by delivering faulty, decades-old munitions to Afghan security forces. The 22-year-old company president and three colleagues were indicted on 71 counts related to the sale of \$298 million of Chinese ammunition through a DoD contract. (As reported in *Government Executive*, June 23, 2008.)

"Army Officer Pleads Guilty to Conspiracy, Bribery and Money Laundering Scheme Involving DoD Contracts at U.S. Army Base in Kuwait"—While deployed in Kuwait, an Army officer admitted to participating in a bribery and money laundering scheme. The officer was responsible for awarding contracts for services worth millions of dollars to be delivered to troops in Iraq. In return for awarding the contracts, he admitted to receiving or being promised more than \$9 million in bribes. (As reported in *Earthtimes*, June 24, 2008.)

"Former DoD Contractor Pleads Guilty in Scheme to Steal \$39.6 Million Worth of Fuel from U.S. Army In Iraq"—A DoD contractor and his co-conspirators used fraudulently obtained documents to enter Camp Liberty in Iraq. The conspirators presented false fuel authorization forms to steal aviation and diesel fuel for subsequent resale on the black market. The fraud resulted in the theft of 10 million gallons of fuel worth approximately \$39.6 million. One of the conspirators received at least \$450,000 in personal profits from the illegal sale. (As reported in *Marketwatch*, Oct. 7, 2008.)

Fraud, Waste, and Abuse Definitions

Although most people have a general understanding of the term fraud, one of the most widely quoted definitions is found in Black's Law Dictionary:

A false representation of a material fact, whether by words or by conduct, by false or misleading allegations, or by concealment of that which should have been disclosed, which deceives another so that he acts, or fails to act, to his detriment.

The Government Accountability Office's definitions for waste and abuse are:

Waste involves the taxpayers not receiving reasonable value for money in connection with any government funded activities due to an inappropriate act or omission by players with control over or access to government resources (e.g. executive, judicial or legislative branch employees, grantees or other recipients). Most waste does not involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions and inadequate oversight.

Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person

would consider reasonable and necessary business practice given the facts and circumstances. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Abuse does not necessarily involve fraud, violation of laws, regulations or provisions of a contract or grant agreement. ... Payment of incentive and award fees in circumstances where the contractor's performance in terms of cost, schedule and quality outcomes does not justify the fees is an example of contracting waste. In comparison, an example of contracting abuse would include making procurement or vendor selections that are contrary to existing policies or unnecessarily extravagant or expensive. It is important for contracting professionals to be alert to the presence of fraud, waste, and abuse when conducting their work.

Why Do People Commit Fraud?

In the 1950's, famed criminologist Donald R. Cressey developed a hypothesis to explain why people commit fraud. Over the years, his hypothesis has become known as the fraud triangle. The triangle is usually pictured with three common fraud elements: opportunity, motivation, and rationalization. The opportunity to commit fraud occurs when employees have access to organizational assets or information that allows them to commit and conceal fraudulent activity. In general, the opportunities to commit fraud increase when an organization has a poorly designed system of internal controls, or there are persons in positions of authority who are able to override existing controls.

Motivation is also referred to as incentive or pressure. People are motivated to commit fraud for a variety of reasons, and the quest for power is often a common motivator. Pressure to commit fraud can be caused by either internal physical stresses or stresses from outside parties such as collection agencies. Rationalization occurs when the fraudsters convince themselves that their behavior is okay for a variety of reasons. Common rationalizations a person may have include: "I am just borrowing the money and will pay it back when my situation changes"; "The organization does not really need all the money it makes"; or "The organization has not treated me well, and I am going to get back at them."

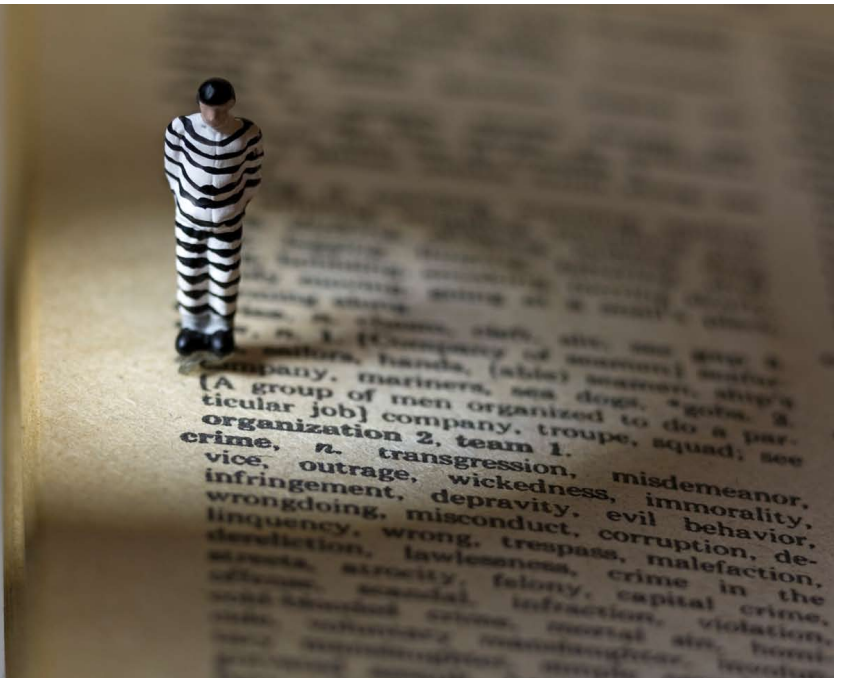
What Does Fraud Mean in DoD?

In addition to becoming familiar with the commonly used definitions of fraud, waste, and abuse, it is important that contracting professionals understand DoD's definition of fraud. DoD Instruction 5505.2, "Criminal Investigations of Fraud Offenses," Feb. 6, 2003, defines fraud as follows:

Any intentional deception designed to deprive the United States of something of value or secure from the United States a benefit, privilege, allowance, or consideration to which he or she is not entitled. Such practices include:

"Things in law tend to be black and white. But we all know that some people are a little bit guilty, while other people are guilty as hell."

Donald R. Cressey, Criminologist, 1919-1987



- *Offering payment or accepting bribes or gratuities.*
- *Making false statements.*
- *Submitting false claims.*
- *Using false weights or measures.*
- *Evading or corrupting inspectors or other officials.*
- *Deceiving either by suppressing the truth or misrepresenting a material fact.*
- *Adulterating or substituting materials.*
- *Falsifying records and books of accounts.*
- *Arranging for secret profits, kickbacks, or commissions.*
- *Conspiring to use any of these devices.*
- *Conflict of interest cases, criminal irregularities, and the unauthorized disclosure of official information relating to procurement and disposal matters.*

A May 2008 Defense Criminal Investigative Service case contained several examples of fraudulent practices prohibited by the department. Specifically, five defendants were involved with a multimillion dollar bribery scheme involving Army Medical Department contracts at Fort Sam Houston, Texas. According to court records, from April 2002 to August 2005, the defendants committed acts of bribery and fraud, accepted kickbacks, and disclosed privileged information to ensure that a defendant-owned company received government contracts.

Fraud Indicators

Fraud indicators are best described as symptoms or characteristics of possible fraud, the result of a fraudulent act, or an attempt to hide a fraudulent scheme. However, a fraud indicator may have nothing to do with a fraud scheme and might simply be a symptom of an internal control weakness within the organization. Similarly, the presence of more than one indicator does not necessarily mean that fraud has oc-

curred. It is important for contracting professionals to be aware of indicators of fraud and fraud schemes when conducting their work.

Procurement fraud indicators are numerous and sometimes may not be obvious, depending on the knowledge and experience of the fraudster. Although this list is not all inclusive, the following are examples of procurement fraud indicators:

- Unusually high volume of purchases from the same vendor.
- Close socialization between government officials and vendors.
- Industry or country has a reputation for corruption.
- Losing bidder cannot be located in business directories.
- Vendor address is a mail drop or a P.O. box with no telephone number or street address.
- Vendor address or phone number matches a government employee's.
- Losing bids do not comply with bid specification, or only one bid is competitive and others are poorly prepared.
- Bidder participated in drafting contract specifications.
- Vague contract specifications followed by change orders.
- Purchase orders of contracts extended by change order rather than rebidding.
- Multiple awards for similar work are given to the same contractor.
- Significant transfers to scrap accounts or inventory write-off accounts.
- Cost is charged to original job order, but no physical inventory is left on the job.
- Apparent high prices compared to similar contracts, price lists, or industry averages.

GREAT MOMENTS IN ACQUISITION HISTORY



1802: Napoleonic Army designers roll out the first camouflage headgear.

- Failure to adequately publicize requests for bids.

The Navy Acquisition Integrity Office (AIO) has developed a comprehensive list of fraud schemes that all DoD contracting professionals should be aware of when conducting their work. Common acquisition fraud schemes identified by AIO include:

- Bribery and Kickbacks—giving or receiving something of value to influence an official act.
- Collusive Bidding—Suppliers and contractors agree to prohibit or limit competition and rig prices to increase the amount of business available to each participant.
- Defective Pricing—Failure to submit current, complete, and accurate cost or pricing data in a price proposal to the government on a negotiated contract.
- Product Substitution—Intentional submission of goods and/or services that do not conform to the contract specifications or requirements.
- False Statements and Claims—Knowingly and willfully submitting false statements or claims with the intent to mislead.
- Unjustified Sole Source—Improper award of a contract without competition or prior review.

The Fight Against Fraud

Although the fight against fraud may seem like an uphill battle, DoD is making tools available to its personnel to

indicators. Subcommittee membership includes representatives from all the military departments; defense agencies; and other DoD organizations, including the Defense Contract Audit Agency, the Office of General Counsel, and the Office of the DoD Inspector General.

The panel took a strong stand against fraudulent activity with the establishment of the Procurement Fraud Indicators Subcommittee, which is chaired by the DoD assistant inspector general for acquisition and contract management in the Office of the DoD Inspector General. Subcommittee members represent a variety of disciplines and DoD organizations, including the Army Audit Agency, Naval Audit Service, Navy Acquisition Integrity Office, and the Air Force Office of Special Investigations.

Where to Find Information on Fraud

A subcommittee accomplishment is a partnering with the Defense Acquisition University to develop an online fraud training module for contracting professionals, available on the DAU Website (<www.dau.mil>) in April 2009. The DAU training will consist of one or two training modules that will take about two hours to complete. The modules will be available to anyone who would like to learn more about acquisition fraud, but are particularly targeted to individuals working in the acquisition field—such as contracting officers and specialists, program managers, and

help them level the playing field. Section 813 of the John Warner National Defense Authorization Act for fiscal year 2007, Public Law 109-364, directed DoD to establish a panel on contracting integrity. The panel consists of senior leaders throughout DoD tasked with conducting a department-wide review of progress made by DoD to eliminate areas of vulnerability in the contracting system that allow fraud, waste, and abuse to occur. The panel established 10 subcommittees to address a variety of issues such as contracting integrity in a combat/contingency environment, sufficient contract surveillance, and the identification of procurement fraud

Although the fight against fraud may seem like an uphill battle, DoD is making tools available to its personnel to help them level the playing field.

contracting officer's representatives—as well as to auditors, investigators, and attorneys. Persons completing the training will qualify for continuing professional education credits depending on the requirements of their field and/or professional license.

The online training has information on more than 15 acquisition fraud scenarios such as purchases for personal use, phantom vendors, and bid information leaks. The first part of the training will define and explain contracting fraud schemes and corresponding indicators. The second phase will provide an opportunity for participants to test their knowledge of fraud schemes and indicators.

A second subcommittee accomplishment is the October 2008 launching of the Fraud Indicators in Procurement and Other Defense Activities Web site (<www.dodig.osd.mil/inspections/apo/fraud/index.htm>), developed by the Office of the DoD Inspector General's Audit Policy and Oversight group. The Fraud Indicators Web site has a variety of resources for procurement professionals, auditors, investigators, and individuals interested in learning more about methods to detect and prevent fraud, waste, and abuse. More than 35 DoD agencies and components, as well as the American Institute of Certified Public Accountants, contributed to the development of the tool.

The Web site includes 40 scenarios and fraud indicators on a variety of topics such as contracting, in-theater operations, healthcare, and base allowance for housing. Contracting scenarios cover a variety of interesting topics such as suspect invoice charges, inherently governmental functions, contract progress reports, and fraudulent invoices. Additional fraud resources located on the Web page include fraud guidance for auditors, fraud handbooks developed by DoD and other federal agencies, information on upcoming fraud training and conferences, a fraud dictionary, an interactive fraud IQ tests, and useful links. Web site visitors are encouraged to submit comments, provide feedback, or submit a fraud scenario.

Reporting Fraud, Waste, or Abuse

Army Criminal Investigative Division
crimetips@conus.army.mil

Naval Criminal Investigative Service
1-800-264-6485 or ncistipline@ncis.navy.mil

Air Force Office of Special Investigations
1-877-246-1453 or hqafosi.watch@ogn.af.mil

Defense Criminal Investigative Service
1-800-424-9098 or hotline@dodig.mil

Additional information and reading material on contracting fraud issues:

Defense Contract Management Agency,
Contract Integrity Center
<http://home.dcma.mil/cntr-dcmac-y/fof/index.htm>

Department of Defense, Office of Inspector General
www.dodig.mil/inspections/apo/fraud/index.htm

Navy Acquisition Integrity Office
<http://ogc.navy.mil/aio.asp>

Army Fraud Fighters
<https://www.jagcnet.army.mil>

Defense Acquisition University
www.dau.mil

National Procurement Fraud Task Force
www.usdoj.gov/criminal/npftf/

If It Looks Like Fraud...

Contracting professionals at all levels are the eyes and ears of DoD. When a contracting professional suspects that something is wrong, he or she should make a referral to a DoD attorney or investigator. It is better to request the assistance of attorneys and investigators when you see smoke instead of waiting for a three-alarm fire. Contracting professionals should not try to assume the role of detective; that is the responsibility of trained professionals. The investigators and attorneys will work together to answer the questions, "Is it fraud or stupidity?" and "Are they guilty as hell?"

Mark S. Boyll, associate general counsel, DoD Office of the Inspector General; Nancy Reuter, supervisory editor, Naval Audit Service; and Joseph P. Bentz, program director, Contract Audits, U.S. Army Audit Agency contributed to this article.

Comments and questions can be provided at <www.dodig.osd.mil/inspections/apo/fraud/commentform.php>.